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Risk Management in the Banking Sector

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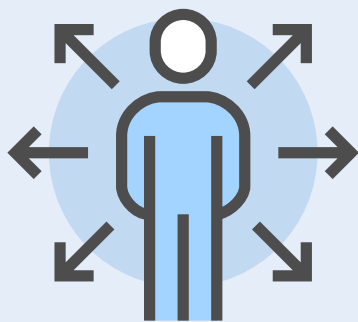
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RISK MANAGEMENT IN THE BANKING SECTOR:

*The influence of personality traits on the
impact of Management Accountants*



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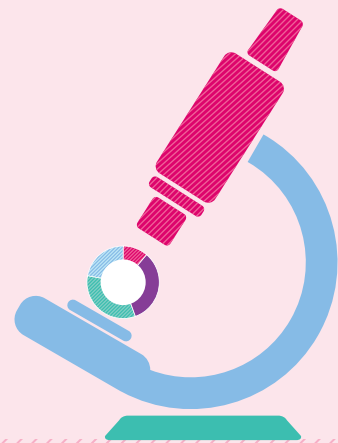
KEY CONCLUSIONS

Since the recent financial crisis, much attention has been paid to risk management, especially in the banking sector. This research conducted in a large Dutch bank explored the involvement of management accountants in risk management and how the degree of this involvement is influenced by their personality traits. The study included both a survey and interviews and resulted in the following key conclusions:

- All management accountants in the bank are to some degree engaged in risk management, but their level of involvement varies both with their formal job design and with the way they shape their jobs. The study also shows that management accountants' involvement in risk management is influenced by their personality traits.
- Being an analytical thinker – or in terms of the "Five Factor Model" of personality traits that was used in the research, scoring highly in conscientiousness – as such is not problematic. Instead, it is a positive attribute, as the survey results show that management accountants scoring highly in conscientiousness are more strongly involved in risk management tasks.
- In order to have an impact on the organization, management accountants need to combine conscientiousness with another specific personality trait. In the bank, this personality trait is referred to as being 'yellow' (according to the Personality Colour Codes). This colour is associated with enthusiasm, persuasiveness, and influencing people. The interviews point out that being 'yellow' is important for the interaction with managers about risk management issues, and, in line with this, the survey research shows that management accountants who score highly in openness to experience interact more frequently with managers.
- The study also shows that, in their interaction with managers (and their subordinates), management accountants need to be careful when discussing risk management issues. The management accountants indicate that there is only a thin line between advising on risk management issues and being too heavily involved to be able to critically assess managers' policies and activities.

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INTRODUCTION

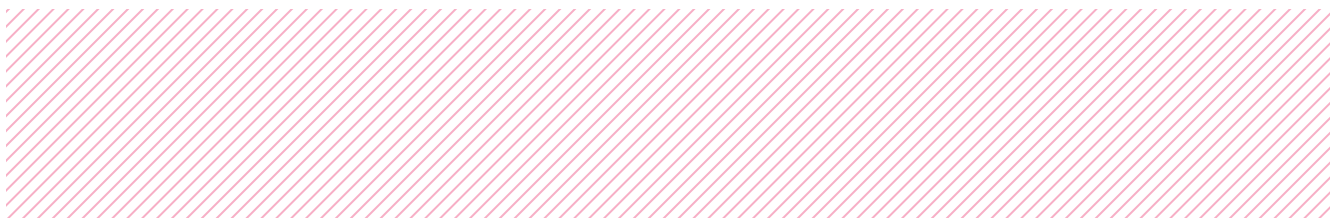
During the run up to the most recent financial crisis, banks seem to have taken intolerably high levels of risk. It is easy to be wise after the event, but for the future this still begs the question as to whose responsibility it is to control risk-taking behaviour. One of the professions that could play a role is the management accounting profession. What exactly is the role of management accountants in risk management, and how could their role in preventing excessive risk-taking behaviour be enhanced in the future?

Various authors agree that the core of a management accountant's role in the organization is having an impact on others in the organization (Lambert and Sponem, 2012; Mouritsen, 1996). Having an impact is also very important for ensuring high-quality risk management. The effectiveness of a management accountant's role in the area of risk management will depend on how managers and others in the organization change their risk-taking behaviours in response to the actions of the management accountant.

This research argues that having an impact on risk-taking behaviours requires management accountants to do more than what is specified in their job description. Individuals have latitude in performing their job, and as such they can actively shape their tasks and interactions with others. As a result, individuals with the same formal job description may play different roles in practice.

Bakker et al. (2012) and Tims et al. (2012) found that the way individuals perform their job depends on particular personality traits. This suggests that personality traits may have an impact on the way in which management accountants perform their jobs in organizations. Some initial support for the relationship between personality traits and the role of management accountants can be found in the work of Blais (2000) and Lynch (1999). According to a recent CIMA report, many financial professionals can be characterized as analytical thinkers, and therefore 'their nature may make it difficult for them to develop empathy with more emotional or intuitive colleagues' (2008, p. 34). One of the problems may be that analytical thinkers are usually more focused on finding solutions than on building and maintaining relationships (cf. Swain and Olsen, 2012).

This leaves us with two questions with respect to the role of management accountants in the risk management of banks. First, how can management accountants increase their impact on risk management practices? Second, what is the influence of their personality traits in this respect? This research addressed these questions through a combination of a survey and interviews. The findings and insights will enhance banks' abilities to select the right person for a management accounting position which involves risk management. In addition, the findings will increase management accountants' awareness of the importance of personality traits in relation to risk management, which may help them to find ways to address risk management issues effectively, given their specific personality traits.

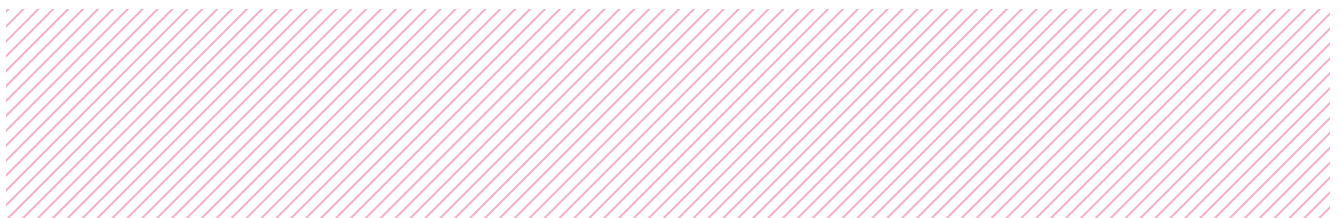


OBJECTIVES

This study sets out to investigate the risk management practices in a large bank as well as the involvement of management accountants in the development and functioning of these practices. The study also explores variations in the roles of management accountants and how these relate to differences in personality traits.

The main objectives of the research are defined as follows:

1. To investigate the development and use of the risk management system in a large bank.
2. To examine: a) the variation in management accountants' involvement in risk management, and b) the relationship between management accountants' personality traits and their involvement in risk management.
3. To explore the role played by personality traits in management accountants' efforts to achieve impact.



RESEARCH METHODOLOGY

Given the variety in research objectives, a mix of research methods was adopted. Both survey research and interviews were used to explore the topics introduced in the research objectives.

To investigate management accountants’ roles and how these are influenced by personality traits, a survey was conducted among management accountants employed at a large Dutch bank. The bank is composed of relatively autonomous branches and a centralized organization. A ‘branch’ is a type of regional structure, which usually comprises multiple locations. Each branch has directors of functional areas as well as various other managers.

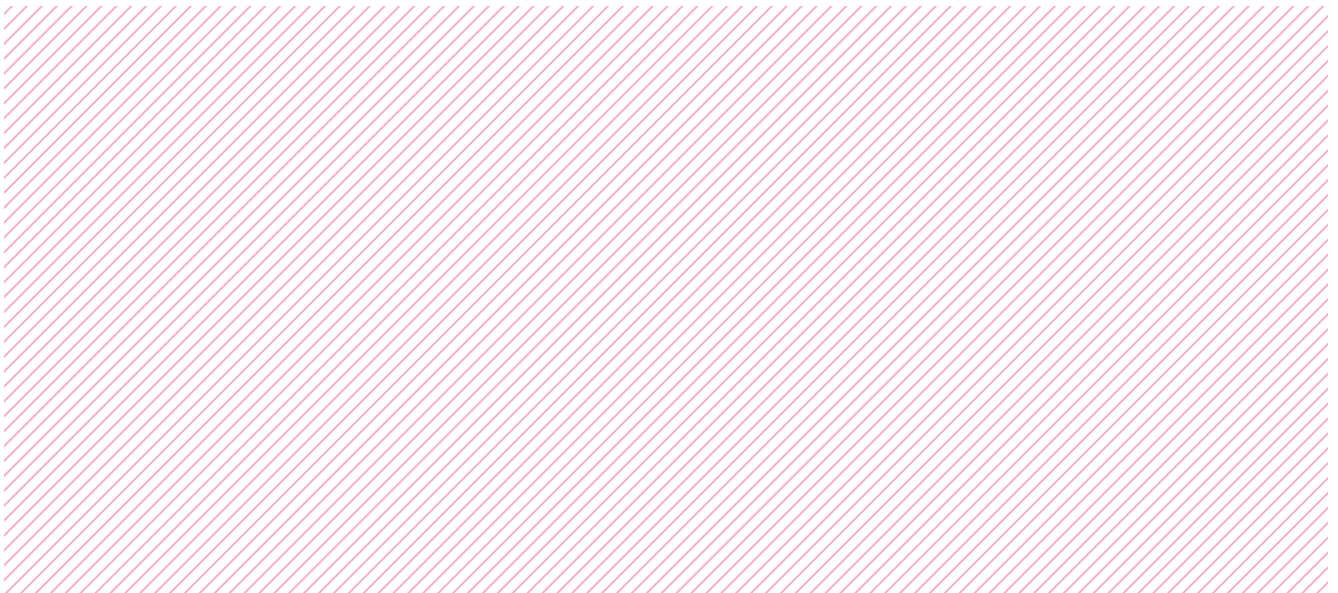
Via an online survey, data were collected from management accountants working at the local branches. The online survey reached 1291 management accountants. The final sample included the completed responses on the main variables of the study of 271 management accountants, which represents a response rate of 22.5 percent. Appendix A gives an overview of the variables used in the data analysis.

Based on the job titles used at the bank, the respondents of the survey were divided into three types: 1) business controllers, 2) financial controllers, and 3) process controllers. Since all respondents work at the same bank, all respondents with the same job title have the same job description and a similar set of formal tasks. This provides a unique setting, and creates the opportunity to investigate differences in activities among management accountants with the same formal job description. Such differences are due to variations in the ways in which management accountants perform their jobs. This study investigates the extent to which these variations, especially in the involvement in risk management, can be attributed to the personality traits of management accountants. The model of personality applied in this research is the “Five Factor Model” (FFM) (see e.g., John and Srivastava, 1999). These personality traits are described in table 1.

TABLE 1: DESCRIPTION OF PERSONALITY TRAITS

| Personality trait | Management accountants with high scores are: | Management accountants with low scores are: |
|---------------------|--|---|
| Extraversion | <ul style="list-style-type: none">• Talkative• Assertive• Energetic | <ul style="list-style-type: none">• Quiet• Reserved• Shy |
| Emotional stability | <ul style="list-style-type: none">• Stable• Calm• Contented | <ul style="list-style-type: none">• Tense• Anxious• Nervous |
| Openness | <ul style="list-style-type: none">• Wide-interests• Imaginative• Inventive | <ul style="list-style-type: none">• Narrow-interests• Commonplace |
| Conscientiousness | <ul style="list-style-type: none">• Organized• Thorough• Planned | <ul style="list-style-type: none">• Careless• Frivolous• Disorderly |
| Agreeableness | <ul style="list-style-type: none">• Sympathetic• Kind• Helpful | <ul style="list-style-type: none">• Fault-finding• Cold• Unfriendly |

In total, 32 interviews were conducted at the bank. The first three interviews were conducted to obtain some background information about the bank and its management accountants. The next set of interviewees was selected from the pool of management accountants who responded to the online survey. These interviewees helped us to contact other persons within the bank, including managers and directors. The topics discussed during the interviews ranged from the formal job description of management accountants, and the ways in which they perform their jobs, to their involvement in and opinions about risk management. Whereas the survey research gives a general overview of relationships between personality traits and roles, the interviews provide more detailed insights into the implications of these relationships for management accountants' impact on risk management.



MAIN FINDINGS AND IMPLICATIONS FOR PRACTICE

The results of the survey show us the extent to which variation exists among management accountants with regard to their involvement in risk management. The results also show us the relationship between personality traits and this involvement. The interviews provide us with some further insights into the risk management practices in the bank and into the roles that management accountants can have with regard to these risk management practices. Particular attention is paid to how management accountants can increase their impact through interaction with managers, and the relevance of personality traits in this regard.

1. DEVELOPMENT AND USE OF THE RISK MANAGEMENT SYSTEM

The financial crisis in The Netherlands

While the first signs of the global financial crisis became visible in the United States in 2007, the negative effects of the crisis became more apparent in The Netherlands in 2008. The global financial crisis had similar effects in the Netherlands as it had in many other countries. The stock and real estate markets collapsed, a number of financial institutions had to be rescued by the Dutch government, and the economy fell into a deep recession. For Dutch banks, the crisis implied, not only that they had to comply with the stricter capital requirements set by the Basel Committee, but also that they came under closer scrutiny of the Dutch financial authorities. With the outbreak of the crisis, it became clear that many institutions had played a questionable role in advising clients on financial products, including life insurance products and endowment mortgages. They sold such products at excessive fees, and without informing the clients properly about the risks involved. The collapse of the financial and real estate markets brought those risks to the surface. As a consequence, the Dutch financial authorities introduced regulation which required financial institutions to always act in the best interest of their customers.

Historical background

Two decades ago, formal risk management was still in its infancy in the bank under investigation. A management accountant who arrived at the bank in 1998 describes how, in his first job as a process controller, he had to introduce process and risk management for the different operating activities of his branch. However, nowadays, risk management has

become a major issue. A branch could have as many as seven management accountants, much of whose work is concerned with risk management. Even business controllers, whose job description is quite broad, point out that they spend 60 to 70% of their time on risk management. Interviewees also indicate that recently some directors have been dismissed because of persistent failures in risk management, while poor financial results have not had the same severe consequences to date.

The Dutch financial authorities played a crucial role in the expansion of the bank's risk management systems. After the financial crisis, they concluded on various occasions that these systems suffered from important weaknesses, and they exerted considerable pressure on the bank to make improvements. The weaknesses were mostly related to the documentation of information about (meetings with) clients. According to the financial authorities, the bank did not sufficiently document its background checks on customers ('Know your Customer' requirements). In addition, the bank was not able to show that its advice to clients had been appropriate given their individual circumstances. Management accountants were then urged to play an important role in mitigating the risks that were identified by the financial authorities. They became responsible for the banks' risk management activities and they implemented the "Three Lines of Defense Model", which resulted in significant change in how the bank dealt with risk-related issues. In addition, the required improvements have had a major impact on the daily work of the bank's advisors. Much more than in the past, they have to collect information about clients, and to formally lay down all the steps they have gone through in advising a particular client. It is now the case that IT systems often force them to follow a particular workflow by requiring them to complete a particular step before they can proceed to the next step.

Three lines of defence

The bank uses the "Three Lines of Defense Model" to organize its risk management activities. This model distinguishes three groups of functions which are involved in risk management (IIA, 2013):

- **first line:** functions that own and manage the risks (operational managers);
- **second line:** functions that oversee risks (risk managers and compliance officers);
- **third line:** functions that provide independent assurance (internal auditors).

In the bank under investigation, the first line includes the managers of the various value chains. The second line consists of the management accountants and compliance officers in the local branches. The third line comprises the internal auditors at the central level. The research focussed on the role of management accountants in risk management, and thus on the second line of defence. Consistent with the model, the management accountants are responsible for facilitating and monitoring the implementation of effective risk management practices by the first line. They are also responsible for monitoring financial risks and for financial reporting issues.

Types of management accountants

The bank under investigation distinguishes three types of management accountants. Firstly, the 'business controllers' are responsible for initiating and monitoring the planning and control cycle and act as a business partner for their director. They strive for the bank to be 'in control'. Business controllers functionally supervise the process controllers. Secondly, the 'process controllers' act as experts in risk and process management in the local branch. The Bank-wide Risk Analysis is the basis for the control activities of the process controller. They provide general support to managers, business controllers and employees. Thirdly, the 'financial controllers' are responsible for performing (financial) analyses in order to provide management information. They act as experts in management control, leaving the business controllers freer to focus on their core tasks. Financial controllers take decisions regarding financial reporting independently.

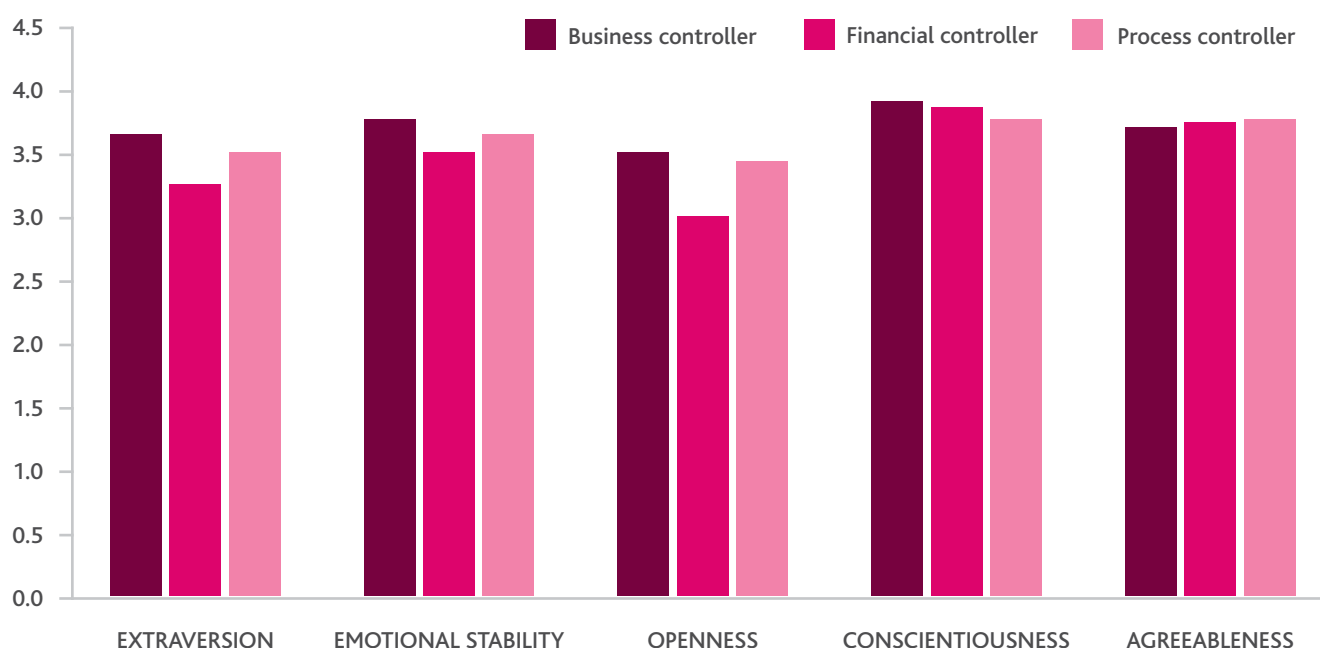
Involvement in risk management

Though only the process controller's job description explicitly refers to risk management, in practice all three types of controllers are involved in risk management. The bank distinguishes operational, tactical and strategic risks. Its operational risk management activities are organized based on the value chains. For each value chain, the responsible manager – together with the process controller – investigates the various operational risks to which the bank is exposed, and he or she prioritizes those risks. To address such risks, the bank has developed policies and procedures which include authorizations and guidelines for documentation. The process controllers periodically evaluate whether these policies and procedures have been followed. They discuss their findings and the necessary follow-up actions with the responsible manager. The business controllers review the work of the process controllers. In addition, together with the responsible director, the business controllers investigate the tactical and strategic risks, based on a SWOT analysis. The financial controllers have a somewhat different responsibility in relation to risk management. They are responsible for balance sheet management. They monitor interest rate risks and liquidity and solvency ratios, and take actions if necessary.

Personality traits

Figure 1 shows the average scores on five different personality traits (as defined by the Five Factor Model) per type of management accountant. The personality traits of conscientiousness and agreeableness do not show significant differences among the three types of management accountants. Extraversion, emotional stability and openness to experience have interesting results, however. Business controllers have significantly higher scores on extraversion and openness to experience than financial controllers and – to a lesser extent – process controllers. In addition, business controllers score most highly for emotional stability of the three types of management accountants. It appears that, in the bank we investigated, management accountants who score highly in extraversion, emotional stability and openness to experience are more likely to select, and to be selected for, a job as a business controller.

FIGURE 1: SCORES ON PERSONALITY TRAITS FOR THREE TYPES OF MANAGEMENT ACCOUNTANTS



2. VARIATION IN ROLES AND PERSONALITY TRAITS

Introduction

Although management accountants with the same job type have the same formal job description, in practice their risk management activities can differ.

The study investigates the relationship between the management accountants' personality traits and their involvement in risk management. To measure involvement we make a distinction between risk management tasks and interactions with managers. More specifically, we examine the variation in the involvement in two tasks which are specifically related to risk management and the variation in the frequency of interaction with managers. The interaction variable is relevant for this research as impact on risk management can be achieved through interaction between those who engage in risk-taking behaviour and those who have to control it.

The two tasks are represented by the variables 'internal control and risk analysis' and 'risk management and policy'. 'Internal control and risk analysis' measures the management accountants' involvement in internal control tasks and in conducting risk-analyses. 'Risk management and policy' measures the management accountants' involvement in risk assessments and in advising on risk-related policy issues. 'Frequency of

interaction' refers to the frequency with which management accountants meet their managers and directors. In presenting the results, we do not distinguish between managers and directors, and instead we refer to both by the term 'managers'.

When comparing the three types of management accountants, we see that process controllers have the highest degree of involvement in internal control and risk analysis, while business controllers have the highest degree of involvement in risk management and policy. Business controllers have the highest score for the frequency of interaction.

Conscientiousness

The conscientiousness personality trait shows a positive relation with the risk management and policy variable. Conscientious management accountants are more organized and thorough (see Table 1). They also tend to be more focused on compliance. This is in line with our finding that they engage more in activities related to risk management and policy, since risk management is concerned, by its very nature, with compliance with rules and regulation. It is notable, however, that there is no positive association between conscientiousness and the internal control and risk analysis variable that measures the involvement in risk management related tasks. A potential explanation may be that management accountants have more latitude with regard to policy issues than internal control activities.

Openness to experience

The results show that management accountants who score highly in openness to experience tend to have more frequent interactions with managers. These management accountants are wide-interested, imaginative and inventive (see Table 1). Individuals with an 'open' attitude are generally more likely to have good relations with others, so this finding is in line with what could be expected. Although the 'open' management accountants have frequent interactions with managers, there is no positive association with the involvement in either of the risk management tasks.

Other observations

Other notable findings are that the personality traits of extraversion, emotional stability, and agreeableness have no significant effect on the investigated variables. In addition, it is noteworthy that according to the survey results, risk management and internal control are not affected by any personality trait. This may well be caused by the lack of possibilities to deviate from the procedures as prescribed in the risk management system.

3. PERSONALITY TRAITS AND IMPACT

Management accountant's latitude

Initially, risk management was to some extent a local affair, but in recent years the bank's central organization has been standardizing such activities more and more. This standardization greatly reduces the autonomy of local branches. It also implies that management accountants have fewer possibilities for adjusting their jobs to their personal preferences. The management accountants increasingly need to follow the guidelines developed at the central level. Some management accountants indicate that they like the strict working methods prescribed by these guidelines. In their view, the guidelines offer a common language to discuss issues, both with management accountants from other branches and with managers within the own branch.

Although the ability of management accountants to give a local flavour to the risk management system has been reduced, they still have a considerable degree of freedom to adjust their interactions with managers to their personal preferences. For instance, whereas discussing the findings of evaluations with the responsible manager is formally part of their job, it is up to the individual management accountants to decide whether they maintain contact with managers during the implementation of the follow-up actions. Some management accountants consider that supporting managers at this stage is an important part of their jobs, while others prefer to stay at a distance. Interviewees also describe how they consciously choose between writing an e-mail and organizing a face-to-face meeting. Some also indicate that they have increased the number of informal contacts with their manager(s) to catch up on new developments.

The influence of personality

The bank offers a wide range of educational and training programs to its management accountants. In addition to more content-related programs, many management accountants have followed training programs aimed at increasing their impact on managers. An important element in these programs is the influence of personality. The programs distinguish different personalities and label them with different colours. Management accountants often know which colours they and their direct colleagues have, and they associate these colours with particular behaviours.

Interviewees indicate that many management accountants are 'blue'. Blue management accountants tend to focus on facts and on compliance with rules, and they prefer to work in a structured manner. Other management accountants are more 'yellow', sometimes in combination with 'red'. The 'yellows' are friendly and outgoing, and have strong communicative skills, while the 'reds' are proactive and have the ability to get things done. See Figure 2 for the interpretation of the four colours used in the bank.

FIGURE 2: PERSONALITY COLOUR CODES



According to the management accountants we interviewed, a focus on compliance and a structured way of working are important attributes in the context of risk management. However, they also share the view that for management accountants 'being too blue' is a disadvantage. They stress that their job is not only to observe deviations from the guidelines and standards, but also to advise managers, to be an effective business partner for them, and to help them to make improvements. They want to have an impact on the organization.

'If you observe something, but you are not able to steer the branch in the right direction, you are still not in control.'

The interaction with managers

The bank encourages its management accountants, and particularly the 'blue' ones, to develop their competences to address their weaknesses and to increase their impact. The training programs that are offered by the bank seem to have created a common understanding of how impact can be achieved. Many management accountants use the term 'reflect' to indicate that they should not propose solutions to managers, but should encourage managers to look critically at their own work and to come up with solutions themselves.

'I think you have to be able to get along, both with the managers and the director, in such a way that you can also be critical, and that you can be a good listener. Not a trouble shooter, but with the intention of giving them food for thought.'

The management accountants also indicate that it is important to maintain good relationships with managers. From experience they know that, to maintain good relationships, they have to be careful when presenting to managers the findings of evaluations. They emphasise the importance of distinguishing between important and secondary issues, and focusing their discussions with managers on the important issues. They also stress that the specific circumstances must be taken into account when making an assessment of the situation.

'So, yes, I could make some bold statements, but at the end of the day I'll have to go back again [to the managers] to discuss what to do. Therefore, if I communicate something that is not correct, or not mutually supported, well, then I will lose my impact on the department.'

Finally, the management accountants point out that they should be able to adjust their style of communication to the style of the manager. In their view, a 'red' manager needs a different approach as compared to, for instance, a 'yellow' one.

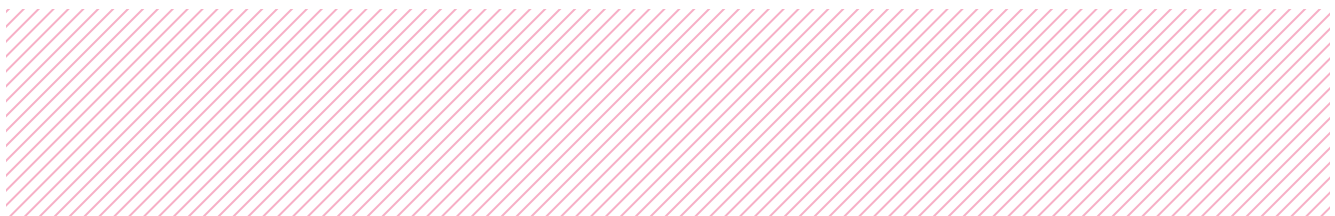
'Take, for example, controllers, what type of people are they? Well, I suppose that nine out of ten could be characterised by the colour blue; myself included. But you just know – and this is where you can improve yourself through training and by acquiring some skills – how can you, in spite of how you are as a person, still make that connection with the other who may not be blue. Or yellow, or red, or green.'

A thin line

Although interacting with managers is an important part of their jobs, many of the management accountants we interviewed struggle with their exact role. As such, being part of the second line of defence is considered problematic. On the one hand, the management accountants have to support the managers in their efforts to develop and operate a high-quality risk management system. On the other hand, they are responsible for assessing whether the first line is executing its risk management tasks properly. With this dual responsibility, management accountants run the risk of having to assess the quality of particular measures which they themselves have proposed at an earlier stage.

'Yes I think that occasionally we do wear different hats. See what would have happened if I was now still involved in that value chain. Last year's adjustments following the evaluation took almost a year, far too long. Anyway, if I was still involved in that chain, I would have to say something about it this year.'

The research shows that many management accountants need some experience to find an appropriate way of dealing with this problem. A solution that seems to work in many situations is to avoid giving concrete answers about risk management issues to questions from managers or advisors. Instead, the management accountants propose directions to deal with the issue: for example, take a look at particular regulation, discuss the issue with a colleague, ask your manager. As such, the management accountants seem to have learnt that sometimes they must resist their natural tendency to focus on the facts and to solve the managers' and advisors' problems.



CONCLUSION

Management accountants can have an impact on the quality of a bank's risk management. The involvement in risk management depends on the type of management accountant and his or her personality traits. The interaction between management accountants and managers is key to achieving a higher quality of risk management.

Many financial professionals can be characterized as analytical thinkers (CIMA, 2008, p. 34). Our research shows that being an analytical thinker – or in terms of the “Five Factor Model” we used, scoring highly in conscientiousness – as such is not problematic. Instead, it appears to be a positive attribute, as the survey results demonstrate that high scores on conscientiousness are positively related to high levels of involvement in risk-related policy issues.

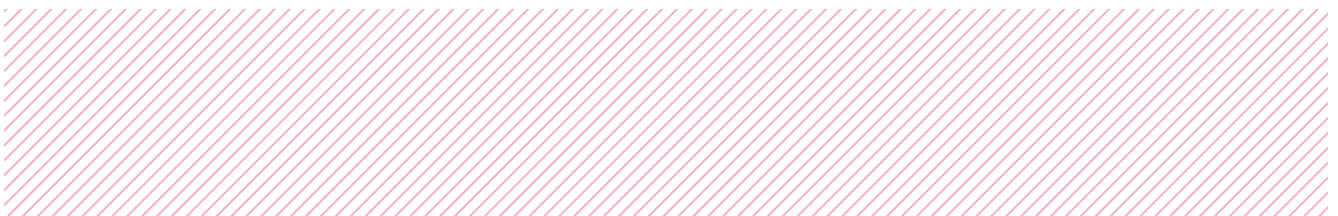
The interviews revealed that, rather than deemphasising conscientiousness, management accountants must balance conscientiousness with another personality trait. The bank we investigated uses the colour ‘yellow’ to refer to this other personality trait. This colour represents the degree to which someone is focused on interactions with other persons. With such a mix of personality traits, management accountants can increase their impact on the business.

The survey shows that the degree to which management accountants interact with managers is closely related to their score on openness to experience. According to the “Five Factor Model”, there are five distinct personality traits, and openness to experience is a personality trait that can be distinguished from conscientiousness. It follows from this that management accountants who score highly in conscientiousness do not necessarily have low scores for openness to experience. Consequently, management accountants may well combine conscientiousness with openness to experience.

The findings also show that:

- Management accountants’ interactions about risk management issues with managers are a delicate affair. The management accountants in our study agreed that there is only a thin line between advising managers on risk management issues and being too heavily involved to be able to critically assess those managers’ policies and activities.
- Management accountants struggled with being the second line of defence in the “Three Lines of Defense Model” of risk management. Whereas the first line can fully focus on the implementation of risk management, and the third line can easily take the role of independent assessor, the management accountants in the second line have constantly to walk a tightrope.

We conclude that management accountants who score highly in both openness to experience and conscientiousness are more likely to enhance the quality of a bank's risk management. If banks recruit management accountants with these personality traits, they can enhance the possibility of selecting the right person for a management accounting role which involves risk management. In addition, if management accountants are more aware of their specific personality traits, they should be in a better position to find ways of dealing with risk management issues.



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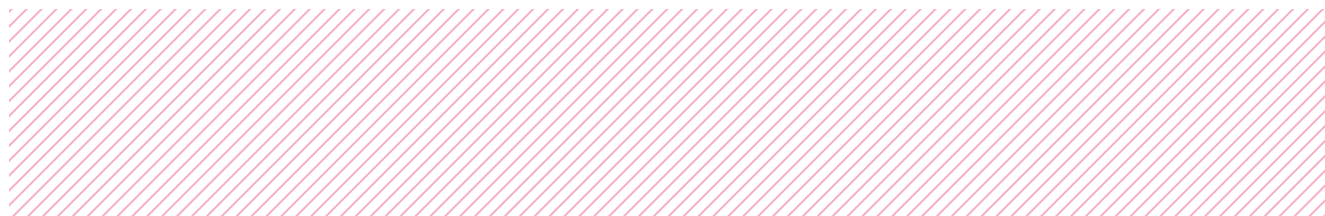
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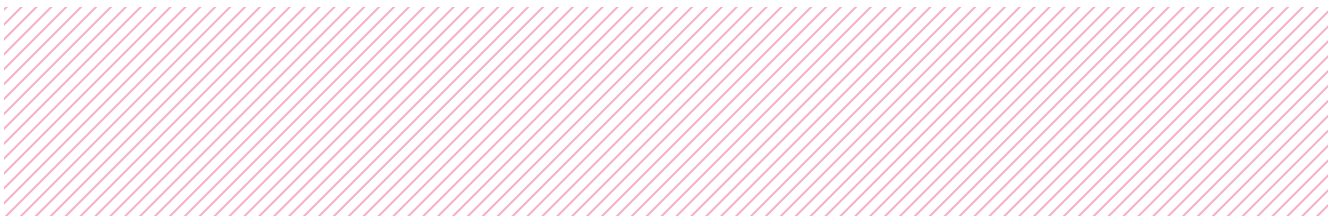


APPENDIX A: SURVEY RESEARCH VARIABLES

Risk management and internal control is the variable that measures the management accountant's involvement in a set of internal control tasks, while Risk management and policy is the variable that measures the involvement in a set of risk and policy tasks. The scale items have been measured on a Likert scale from 1 to 7. The frequency of contact between the management accountant and the manager is measured using a scale that is based on Chapman (1998). The scale items have been measured on a Likert scale from 1 to 5.

Secondly, the questionnaire included statements that can be related to personality traits: extraversion, emotional stability, agreeableness, conscientiousness and openness to experience. This personality framework is the "Five Factor Model" (FFM) (see e.g., John and Srivastava (1999)). The responses to these statements can be used to measure the different personality traits and have been measured on a 5-point Likert scale.

Finally, the following control variables have been included in the analyses: type of controller, work autonomy, task interdependence, organic structure, size of the branch and age and tenure.



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